

WATER/RSK/BMD/JB5/MZ3/jlj

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS
Water and Sewer Advisory BranchRESOLUTION W-4932
September 27, 2012**R E S O L U T I O N**

(RES. W-4932), GOLDEN STATE WATER COMPANY (GOLDEN STATE) ORDER SEEKING AUTHORIZATION TO ESTABLISH THE INCOME TAX REPAIR REGULATIONS IMPLEMENTATION MEMORANDUM ACCOUNT (ITRRI-MA) TO TRACK THE COSTS ASSOCIATED WITH THE IMPLEMENTATION OF NEW TAX RELATED REPAIR REGULATIONS.

SUMMARY

By supplemental Advice Letter (AL) 1498-WB, filed on August 28, 2012, Golden State, a Class A water utility, seeks authorization to establish the Income Tax Repair Regulations Implementation Memorandum Account (ITRRI-MA). The purpose of the ITRRI-MA is to track the costs the utility will incur, including setting up the necessary accounting systems and obtaining any other outside services needed, in order to implement new tax regulations relating to the tax treatment of repairs that federal agencies issued in December 2011 and March 2012. This Resolution authorizes Golden State to establish the ITRRI-MA for the limited purpose of tracking associated necessary costs incurred in order to allow the utility to be able to implement these new regulations. These regulations are effective and would provide significant tax benefits to Golden State and its ratepayers, if Golden State were able to implement them with respect to repairs it conducts. Accordingly, it is in the interest of Golden State and its ratepayers for the utility to put in place the necessary changes to the accounting systems as soon as possible to begin implementing these new repair regulations. The goal is for Golden State to have all needed systems in place so that it can begin implementing these regulations beginning January 1, 2013. (This will be the effective date of Golden State's current general rate case (GRC).¹) Golden State may track appropriate costs incurred, for the reasons discussed above, after the ITRRI-MA becomes effective. However, the maximum amount of costs to implement these

¹ Application (A.) 11-07-017. The Commission has not yet acted on this application.

federal tax regulations that Golden State may incur and track in the ITTRI-MA, and subsequently seek reimbursement from ratepayers, are capped at \$900,000.²

BACKGROUND

On August 21, 2006, the Internal Revenue Service (IRS) and the U.S. Treasury Department published in the Federal Register (71 FR 48590-01) proposed amendments to the Internal Revenue Code relating to “amounts paid to...improve tangible property.” After receiving written comments and holding a public hearing, the IRS and the Treasury Department withdrew the 2006 proposed regulations on March 10, 2008, and proposed new regulations (73 FR 47 12838-01) relating specifically to the deduction of items for business expenses and the capitalization requirement. Subsequent public comment was considered and incorporated into a final package of regulations.³

The Treasury Department issued these final regulations (T.D. 9564) on December 23, 2011, and the IRS issued related guidance in March 2012. Section III of T.D. 9564 entitled “Repairs Under §1.162-4” states:

The 2008 proposed regulations proposed to revise §1.162-4 (the repairs regulation)...(and) provided that amounts paid for repairs and maintenance to tangible property are deductible if the amounts paid are not required to be capitalized under §1.263(a)-3...The proposed regulations...clarify that a taxpayer is permitted to deduct amounts paid to repair and maintain tangible property provided such amounts are not required to be capitalized under section 263(a) or any other provision of the Code or regulations.

The IRS or the California Franchise Tax Board (FTB) may issue further guidance on these matters in the future. The regulations and guidance (collectively, “repair regulations”) provide for several tax accounting changes, one of which accelerates the recovery of repair costs for tax purposes. Repair costs, which are normally capitalized, would now be treated as expensed items. Consequently, when Golden State implements the repair regulations, it is anticipated that Golden State will claim a significant net income tax deduction.

²The \$900,000 cap was negotiated between Golden State, the Division of Ratepayer Advocates (DRA), and The Utility Reform Network (TURN) and is part of a Settlement Agreement these parties reached and that the Commission will be evaluating in A. 11-07-017. (See the discussion immediately below in this resolution.) This resolution does not prejudice what the Commission may do in this proceeding regarding this matter (or any matter in the Settlement Agreement). Accordingly, Golden State is on notice that it may be at risk for the costs tracked in the ITRRI-MA depending on the outcome of A.11-07-017. (Regarding recovery risks in general for costs tracked in a memorandum account, see also the discussion below in this resolution in the section entitled Memo Account Approval.)

³ Department of the Treasury, “Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property,” 76 Federal Register 248 (December 27, 2011), pp. 81060 – 81127.

Unless the corresponding deferred tax effects are recorded on a normalized basis that adjusts rate base, the anticipated net tax benefit from the repair regulations prior to the next GRC will not be preserved for ratepayers. Golden State will fully normalize the effects as they are realized in accordance with the normalization requirements of the Internal Revenue Code. As Golden State records normalized deferred taxes in rate base during the years of the current GRC, ratepayers may also realize a benefit in the attrition year filings. In addition, ratepayers will benefit from the repair regulations in the next GRC with rate base in the 2016 test year reflecting normalized deferred tax consequences of the repair regulations in pre-2016 years.

The purpose for establishing the ITRRI-MA is to reconcile the timing disconnect between the need to incur costs now in order to implement the repair regulations as soon as possible and before January 1, 2013, at the latest, and the expected off-setting revenues proposed in rates that are to become effective beginning January 1, 2013, once the Commission acts in Golden State's current GRC, A.11-07-017. Golden State will incur costs associated to implement the repair regulations (e.g., outside implementation service fees and required accounting system changes). These costs will be tracked in the ITRRI-MA each month and will be subject to a reasonableness review as part of Golden State's next GRC scheduled to be filed July 1, 2014. Golden State has agreed, as part of a Settlement Agreement in A.11-07-017, that the costs tracked in the ITRRI-MA will be capped at \$900,000.

In A. 11-07-017, Golden State is requesting recovery of implementation costs in rates over the three-year rate case period. Each year Golden State proposes to collect \$300,000 in rates to cover the implementation costs. Golden State will refund to ratepayers as part of its next GRC the difference between collected revenue and reasonably incurred cost capped at \$900,000. Golden State is at risk for all costs incurred in excess of the \$900,000 cost cap (or for costs incurred up to this cap in light of matters that may come out of the Commission's action on A. 11-07-017, as discussed in footnote 2 above). (For other recovery risks, see also the discussion below in the Memo Account Approval section of this resolution.) Golden State will track the revenues collected through rates associated with implementing the new repair regulations as credit entries made at the end of each month to the ITRRI-MA.

NOTICE AND PROTESTS

Supplemental AL 1498-WB was served on August 28, 2012, in accordance with General Order 96-B, on adjacent utilities, persons on the general service list, and parties to A.11-07-017. No protests were received.⁴ Customer notice is not required because this advice letter is not requesting higher rates or charges, or more restrictive terms or conditions, than those currently in effect.

⁴ The supplemental filings incorporated informal comments from the Division of Water and Audits and Division of Ratepayer Advocates (DRA) and replaced in their entirety both AL 1498-WA, served on August 1, 2012, and AL 1498-W, served on July 26, 2012.

DISCUSSION

Golden State requests authorization to modify its Preliminary Statements, to add Part CCC, attached to this Resolution, and establish the ITRRI-MA to track the costs, including outside implementation service fees and required accounting system changes, and revenues associated with the implementation of recently issued repair regulations.

Definition and Tier Classification

A memorandum (memo) account, as defined in paragraph 6 of the Commission Standard Practice U-27-W, Standard Practice for Processing Rate Offsets and Establishing and Amortizing Memorandum Accounts (SP U-27-W), is “an accounting device used by a utility to record various expenses it incurs. The utility may later seek authorization from the Commission to recover the recorded amounts by passing them on to consumers in rates.”

The establishment of a new memo account requires a Tier III advice letter designation and disposition by resolution. General Rule 7.6.1 of General Order (GO) 96-B states:

Industry Division disposition is appropriate where statutes or Commission orders have required the action proposed in the advice letter, or have authorized the action with sufficient specificity, that the Industry Division need only determine as a technical matter whether the proposed action is within the scope of what has already been authorized by statutes or Commission orders.

In this case, we have not previously required or authorized Golden State to establish a memo account to track the costs associated with the implementation of the repair regulations issued by the U.S. Treasury Department in December 2011. Consequently, disposition of AL 1498-WB does not constitute a “ministerial” act and requires disposition by Commission resolution. Golden State has correctly classified AL 1498-WA as a Tier III filing.

Memo Account Justification

According to SP-U-27-W, memo accounts track costs that the Commission has directed to be tracked and costs that have been approved to be tracked due to events of an exceptional nature that can be characterized as follows:

- (1) are not under the utility’s control,
- (2) could not have been reasonably foreseen in the utility’s last GRC,
- (3) ...will occur before the utility’s next scheduled rate case,
- (4) are of a substantial nature in that the amount of money involved is worth the effort of processing a memo account, and

(5) have ratepayer benefits.⁵

We will address the merits of AL 1498-WA considering the aforementioned criteria.

1. The event is not under the utility's control.

The repair regulations issued as T.D. 9564 in December 2011 and the related regulations issued by the IRS in March 2012 were the result of internal operations at the U.S. Treasury Department and the IRS. Therefore, the causal events impacting Golden State's tax status were not under the utility's control.

2. The event could not have been reasonably foreseen in the utility's last GRC.

Golden State's taxes were last addressed for Regions II, III, and General Office in its GRC Application, A. 08-07-010, which established rates effective January 1, 2010. Golden State's taxes were last addressed for Region I in its GRC Application, A. 10-01-009, which established rates effective January 1, 2011. T.D. 9564 was issued in December 2011 after earlier withdrawals and revisions of previous proposed regulations. Golden State could not have been aware of the final language nor the date of promulgation of the repair regulations when it filed A. 08-07-010 in July 2008 and A. 10-01-009 in January 2010.

3. The event will occur before the utility's next scheduled rate case.

Golden State filed its current GRC, A.11-07-017, in July 2011, and the Commission has not yet acted on this application. The rate request in this GRC is for rates that will become effective starting January 1, 2013.⁶ The Commission has given authority to Class A water utilities to include expense items in a memo account that it can show will "occur prior to its next rate case, but the amount of which cannot be reasonably estimated for inclusion in its rate case request."⁷ The federal regulations were issued in December 2011 and March 2012 and became operative subsequent to Golden State filing of A.11-07-017. In order to capture the tax benefit for ratepayers beginning January 1, 2013, the implementation of the repair regulations, and thus the costs associated with their implementation, will need to occur as soon as possible and prior to the effective date of Golden State's current GRC and doing this is in the mutual interest of Golden State and its customers. Golden State will not file its next GRC until July 1, 2014.

⁵ See SP-U-27-W (para. 25).

⁶ It is possible that the Commission may not act on A.11-07-017 by January 1, 2013. However, consistent with Commission practice, if on January 1, 2013 the existing rates remain or interim rates are put into effect, these rates will be trued up or down, as appropriate, going back to January 1, 2013, once the Commission acts to approve final rate in A.11-07-017.

⁷ D.94-06-033, June 22, 1994, p. 51.

4. The event is of a substantial nature in that the amount of money involved is worth the effort of processing a memo account.

The initial implementation costs are of a substantial nature because they represent a significant amount of money to Golden State. Supplemental documentation submitted by Golden State estimates the implementation costs to be in the range from \$800,000 to \$1,050,000 including outside implementation service fees and required accounting system changes. Golden State agrees that the amount to be recorded in the ITRRI-MA will be capped at \$900,000.

5. The memo account has ratepayer benefits.

The new repair regulations are anticipated to create a significant net income tax deduction to be normalized and passed on to ratepayers in subsequent Commission filings. The benefit of Golden State implementing the repair regulations as soon as possible is that the tax benefits will be recognized with Golden State's first attrition filing in 2014. Golden State will account for the temporary tax timing differences resulting from implementation of the repair regulations on a normalized (rather than flow-through) basis in order to preserve the benefit of implementing the repair regulations for future rate cases.

Golden State is not able to quantify the effects of normalizing the repair regulations at this time as it will not know the expected income tax deductions from the change in the tax related repair regulations until a study is commissioned to estimate the amount of these deductions. However, Golden State, DRA, and TURN agree that the benefit to Golden State's customers is substantial in nature and will outweigh the costs of implementation recorded in the ITRRI-MA.

Memo Account Approval

A memo account is not a guarantee of the eventual recovery of expenses and the burden of proof of the reasonableness of the expenses charged to the account is the responsibility of the utility requesting reimbursement of such expenses. If Golden State seeks recovery in rates of net costs tracked in the ITRRI-MA in its next GRC, it has the burden of proof to show that: (1) it acted prudently when it incurred these costs; (2) the level of booked costs is reasonable; (3) the costs incurred are not covered by other authorized rates; and (4) it is appropriate for ratepayers, as a matter of policy, to pay for these categories of costs in addition to otherwise authorized rates.⁸

With this caveat, AL 1498-WB is approved and Golden State is authorized to establish the ITRRI-MA consistent with Tariff Sheet No. W-6422-W* attached to this Resolution. We find that this request is compatible with the public interest, sound financial practices, and proper performance by Golden State as a public utility.

⁸ See Resolution W-4824, Ordering Paragraph #5.

COMMENTS

This is an uncontested matter that grants the relief requested. Pursuant to Public Utilities Code Section 311(g) (2) this draft resolution was not mailed for comment.

FINDINGS AND CONCLUSIONS

1. By AL 1498-WB filed on August 28, 2012, Golden State Water Company (Golden State), a Class A water utility, seeks authorization to establish a new memorandum account, the Income Tax Repair Regulations Implementation Memorandum Account (ITRRI-MA), to track the costs associated with implementation of new repair regulations the U.S. Treasury Department issues and guidance related to these regulations that the Internal Revenues Service issued (collectively referred to in this Resolution as the repair regulations).
2. The new repair regulations provide for several tax accounting changes, one of which accelerates the recovery of repair costs for tax purposes. Pursuant to the repair regulations, utilities will expense repair costs, which utilities currently normally.
3. When Golden State implements the repair regulations and thus can begin to expense repair related costs, it is anticipated that Golden State will claim a significant net income tax deduction.
4. Golden State will seek to preserve the anticipated net tax benefits of implementing the repair regulations prior to the next general rate case (GRC) by recording their effects on a normalized basis.
5. Golden State will fully normalize the effects of the anticipated net tax benefits as they are realized in accordance with the normalization requirements of the Internal Revenue Code.
6. Golden State will incur costs associated with implementing the repair regulations, which will include outside implementation service fees and required accounting system changes, and will record these costs each month in the (ITRRI-MA).
7. Golden State has agreed that the costs tracked in the ITRRI-MA will be capped at \$900,000.
8. Golden State proposes to collect revenues related to the implementation of the repair regulations through rates that will be set in its current GRC, A.11-07-017. Revenues will be collected over three years and documented in the ITRRI-MA by credit entries made at the end of each month.
9. To the extent the implementation costs are less than what is forecasted in rates set in its GRC in A. 11-07-017, Golden State will refund the difference to its customers.
10. The issuance of the repair regulations was not under the control of Golden State.

11. Golden State could not have reasonably foreseen the expenses associated with the new repair regulations during its last general rate case.
12. The costs of implementing the new repair regulations as soon as possible and before January 1, 2013, will be incurred prior to the establishment of rates pursuant to Golden State's current GRC in A.11-07-017.
13. These costs are of a substantial nature because they represent a significant amount of money to Golden State.
14. Currently, Golden State is not able to quantify the benefits of implementing the repair regulations but believes them to be substantial in nature and greater than the costs of implementing the repair regulations.
15. Golden State should be authorized to establish the ITRRI-MA to track the costs with its implementation of the repair regulations consistent with Tariff Sheet No. 6422-W* attached to this Resolution. Golden state should be authorized to track the revenues recovered in rates associated with its implementation of repair regulations consistent with Tariff Sheet No. 6422-W* attached to this Resolution.

THEREFORE IT IS ORDERED THAT:

1. Golden State Water Company's Advice Letter 1498-WB seeking authorization to establish the Income Tax Repair Regulations Implementation Memorandum Account attached in Tariff Sheet No. 6422-W* to this Resolution for the purpose of tracking costs, and revenues recovered in future rates, associated with the implementation of U.S. Treasury Department regulations issued in December 2011 (T.D. 9564) and Internal Revenue Service guidance corresponding to these regulations issued in March 2012 (collectively referred to as the repair regulations), is approved effective today.
2. Golden State Water Company is authorized to record costs, which include but are not limited to outside implementation service fees and required accounting system changes, and revenues recovered in future rates, associated with implementing the repair regulations identified in Ordering Paragraph 1 above in the Income Tax Repair Regulations Implementation Memorandum Account consistent with Tariff Sheet No. 6422-W* attached to this Resolution.
3. If Golden State seeks recovery in rates of net costs tracked in the Income Tax Repair Regulations Implementation Memorandum Account in its next general rate case, it has the burden of proof to show that: (1) it acted prudently when it incurred these costs; (2) the level of booked costs is reasonable; (3) the costs incurred are not covered by other authorized rates; and (4) it is appropriate for ratepayers, as a matter of policy, to pay for these categories of costs in addition to otherwise authorized rates.

4. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at the Public Utilities Commission of the State of California on September 27, 2012. The following Commissioners voting favorably thereon:

PAUL CLANON
Executive Director

GOLDEN STATE WATER COMPANY
630 EAST FOOTHILL BOULEVARD P.O. BOX 9016
SAN DIMAS, CA 91773-9016

Original Cal. P.U.C. Sheet No. 6422-W*

Canceling _____ Cal. P.U.C. Sheet No. _____

PRELIMINARY STATEMENTS

(Continued)

**CCC. INCOME TAX REPAIR REGULATIONS IMPLEMENTATION MEMORANDUM
ACCOUNT (ITRRI-MA)**

(N)

1. Purpose

The purpose of the ITRRI-MA is to track the costs associated with the initial implementation of the Repair Regulations and will include (i) outside implementation service fees and (ii) required accounting system changes, in compliance with the U.S. Treasury Department regulations (issued in December 2011 (T.D. 9564) and the Internal Revenue Service ("IRS") guidance (issued in March 2012. The amount to be recorded in the ITRRI-MA will be capped at \$900,000.

The Repair Regulations provide for several tax accounting method changes, one of which accelerates the recovery of repair costs for tax purposes. Repair costs which are normally capitalized, would now be treated as expensed items. By adhering to these Repair Regulations, GSWC anticipates a significant net income tax deduction.

Note: Further guidance may be issued by the IRS or the California Franchise Tax Board. GSWC will file an advice letter to amend this preliminary statement, if deemed necessary, to include any new related regulations and/or guidance.

2. Applicability

GSWC shall maintain the ITRRI-MA by making entries as follows:

- a. A debit entry shall be made to the ITRRI-MA at the end of each month to record any costs associated with implementing the Repair regulations.
- b. A credit entry shall be made to the ITRRI-MA at the end of each month to record the ITRRI-related revenue collected in rates.
- c. The ITRRI-MA will accrue interest on a monthly basis by applying a rate equal to one-twelfth of the 3-month Commercial Paper Rate, as reported in the Federal Reserve Statistical Release, to the average of the beginning-of-month and the end-of-month balances.

3. Effective Date

The ITRRI-MA will be made effective upon Commission approval.

4. Disposition

The ITRRI-MA will be reviewed in GSWC's next GRC. To the extent these costs are less than what is forecasted in rates, GSWC will refund the difference to its customers.

(N)

Advice Letter No. 1498-WB
Decision No. _____

ISSUED BY
R. J. SPROWLS
President

Date Filed: _____
Effective Date: _____
Resolution No. _____